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ICPS newsletter

Public economic policy promotes economic revival in Ukraine

A new issue of ICPS's Quarterly Predictions journal will be published this week. We have adjusted our forecast for GDP growth in Ukraine upwards: it will reach 2% in 2000 and 3% in 2001. Improved economic policy will lead to a rise in demand and an increase in productivity across the economy

In Q1'00, real GDP grew by 5.6% y-o-y. In our opinion, economic revival resulted from the following:

· Household consumption increased for the first time since the 1998 financial crisis. This indicates that households have positive expectations regarding their future incomes. Light industries benefited from an increase in domestic demand the most, as they managed to raise profitability and improve technologies on the wave of import substitution.

· Conditions in foreign markets remained favourable. High global demand for metal products stimulated Ukrainian metalworks to increase their exports.

· National economic policy improved, due to the achievement of political consensus among the arms of government. First, the re-election of Leonid Kuchma as President, and formation of the new Cabinet of Ministers headed by Viktor Yuschenko, affirmed the irrevocability of market reforms in Ukraine. Second, the government attained macroeconomic stability in the country by means of strict budget policy and the restructuring of foreign debts to private lenders. Third, the introduction of a simplified tax system helped small businesses reduce their costs of tax accounting.

We have adjusted our forecast for GDP growth in Ukraine upwards in 2000 and 2001, as the rise in demand will be matched by an increase in productivity across the economy, as well as by improvements in economic policy. GDP growth will reach 2% in 2000 and 3% in 2001. We built our forecast on the following assumptions:

1. Increasing productivity:

· The household and business sectors have adjusted to market conditions, and have acquired a certain amount of experience. This will strengthen competition in domestic markets.

· Deepening and accelerating privatisation. Explicitly defined property rights, through the concentration of stock in private hands, will encourage entrepreneurs to invest in the long-run development of their businesses.

· Investment inflow. If the initiated reforms are implemented and the business climate is improved in the future, domestic and foreign investors will support economic recovery in Ukraine, despite the potential refusal of international financial organisations to renew their lending programs.

· Improving contract enforcement. We consider poor contract enforcement to be one of the main impediments to the effective functioning of the Ukrainian economy, since it has caused an accumulation of debts and worsened the investment climate. We forecast that contract enforcement will improve over 2000–2001, thanks to the fine-tuning of relevant legislation.

2. Consistent economic policy:

· Consensus of the legislative and executive branches of power regarding reforms. Consistent economic policy can be implemented, thanks to the support of the president and approval of the Government Action Program by the Verkhovna Rada. General agreement on the strategy and collaboration of the two branches will allow creating an integral legal framework for business development. We anticipate that the Verkhovna Rada will approve the Tax Code and the new Civil Code during 2000–2001.

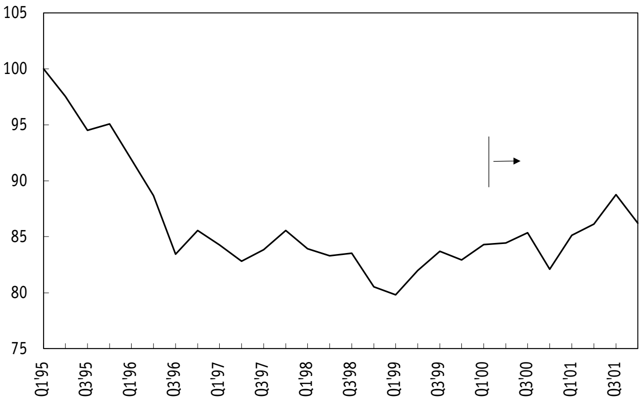
· New procedures for the development and approval of government decisions. These procedures must create conditions for the effective and open discussion of state policy by all interested parties.

The risks to our forecast are the following:

· Reforms may lose public support if routine decisions discord

Real GDP

Index [Q1'95 = 100], seasonally adjusted



Source: State Statistics Committee; calculations and forecast by Quarterly Predictions.

with the government action program. Reforms will not bring positive results if the government makes ill-considered decisions and fails to conform to formal procedures.

· Inconsistent government policy for contract enforcement in the power sector. The ongoing energy crisis threatens economic growth and social stability.

· Failure to complete reforms in the agricultural sector. There is no guarantee that the reorganisation of collective agricultural enterprises will help to increase productivity in the sector, under conditions of an underdeveloped land market infrastructure and chaotic regulation of the agricultural produce market.

· The absence of external support of reforms. If the IMF Extended Facility Fund program and projects of the World Bank are not renewed, Ukraine will face significant difficulties in repaying its foreign debts. Under these conditions, macroeconomic stability will be threatened, as international reserves shrinks, the hryvnia exchange rate becomes even more volatile, and expectations of economic agents worsen.

Ukraine may see worsening conditions in world markets. Since Ukraine's foreign trade turnover exceeds GDP, fluctuations in world markets can affect the financial situation of domestic enterprises significantly. ■

This Week

Discussion of the Government Action Plan: Budget policy in Ukraine. A seminar on "Budget Policy" will be held as a part of a project titled "Ukraine’s Future: Public Feedback on Reform Policy" at ICPS on May 25. Public discussions are organised by the Secretariat of the Cabinet of Ministers of Ukraine, the Ministry of the Economy of Ukraine, and the International Centre for Policy Studies.

The following questions will be discussed by seminar participants:

· what are obstacles to implementing budget policy?

· what are tools for implementing budget policy? What measures are the most effective?

· additional measures which are very much needed but missed in the Government Action Plan;

· what are political, economic, social, and technical resources and obstacles to achieving specified objectives?

· what would you recommend to improve the quality of policymaking process in the sphere of budget reform? How can the government change its role in economic regulation? Is it possible to avoid conflicts? What are ways to make and consistently implement policy decisions?

· what would you recommend to improve international technical assistance?

For information on participating in the public discussions, please contact Olga Kolovitskova, tel.: (380-44) 463-5974, e-mail: ok@icps.kiev.ua, or Andrew Bega, tel.: (380-44) 463-5967, e-mail: ABega@icps.kiev.ua

Major indicators

	1999	2000 (forecast)	2001 (forecast)
Economic activities			
GDP, millions UAH	127126	159200	185500
Real GDP, apc*	-0,4	2,0	3,0
Real industrial production, apc	4,3	4,0	5,0
Real agricultural output, apc	-5,7	-5,1	5,0
Gross investment, % of GDP	19,8	20,1	20,8
Direct investment, millions USD (1)	437	700	1100
Real household disposable income, apc	1,2	3,0	4,0
Real retail turnover, apc	-4,8	8,0	5,0
Prices			
Consumer price index, apc	19	19	13
Producer price index, apc	16	18	14
Labour market			
Population, millions	49,8	49,4	49,1
Real wage, average apc	-5,7	1,5	2,5
Official unemployment rate, %	4,3	6,0	8,0
Foreign economic activities			
Exports of goods&services, apc	-7,9	2,6	2,6
Imports of goods&services, apc	-19,1	3,3	4,0
Current account balance, % of GDP	2,7	2,3	1,7
Budget			
Revenues, % of GDP	25,7	26,5	26,8
Current deficit, % of GDP	1,5	-0,4	-0,7
Primary deficit, % of GDP (2)	-0,8	-3,8	-3,7
Monetary indicators			
Monetary base, apc	39	21	16
M3, apc	40	25	18
NBU international reserves, millions USD	1094	1240	1740
Official exchange rate at year end, UAH/USD	4,13	5,76	6,8
Weighted interest rate on loans, yearly % (3)	53	43	35
International			
World GDP, apc	3,3	4,2	3,9
GDP of Ukraine’s major trading partners (2/3 of exports), apc	3,0	3,7	3,4

** apc = annual percent change*

Notes:
(1) according to the NBU
(2) calculated as current deficit minus foreign debt servicing
(3) commercial bank loans, hryvnias

Source: State Statistics Committee, NBU, Finance Ministry; calculations and forecast by Quarterly Predictions.

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